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SUBJECT: AUSTRIA'S ECONOMY: STRONGER GROWTH IN 2007/2008

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Summary

1. Austria's two leading economic institutes recently revised GDP growth forecasts upward for 2007 and 2008. Following 3.2% growth in 2006, latest estimates are for growth of 3.0% in 2007 and 2.4-2.6% in 2008. Strong exports, a robust investment cycle and improving private consumption are propelling growth. Austria's unemployment rate should drop to 4.2-4.5% in 2007 from 4.8% in 2006, but the rate will probably remain stagnant through 2011 due to lower economic growth. Inflation remains low at 1.6-1.8% in 2007-2008. The GoA revised the 2006 consolidated public budget deficit down to 1.1%. However, economists cautioned that a budget deficit of more than 1.0% is too high, given that Austria is at the peak of a growth cycle. Both economic institutes called on the GoA to implement additional structural reforms and to resist spending additional tax windfalls. End Summary.

Dynamic Growth For 2007 and 2008

2. The Austrian Institute for Economic Research (WIFO) and the Institute for Advanced Studies (IHS) recently presented their projections for 2007 and 2008. After a stronger than expected growth rate of 3.2% in 2006, both institutes have revised their 2007 growth forecasts upward to 3.0% (WIFO) and 2.9% (IHS) in 2007. The primary reasons driving the revised outlook include continued strong economic fundamentals; optimistic expectations from Austrian business; strong growth in the Euro area; and dynamic growth opportunities in new EU member states and other important export markets in Eastern and Southeastern Europe. Industry, the construction sector and banks should particularly benefit from strong growth in 2007. With growth of 3.0% or more in both 2006 and 2007, Austria's economy is, however, most likely at the peak of its current cycle.

3. Projections for 2008 are for slightly lower growth of 2.4-2.6% due to the expected slowdown in Europe, a weaker U.S. economy, and slower growth in China. In both 2007 and 2008, growth in Austria should again be higher than the Euro area average, as it has been over the last five years. In both years, strong exports, a robust investment cycle and continued improving private consumption will contribute to growth. The savings rate will remain approximately 9% of disposable income in both years.

Assumptions for Growth Forecasts

¶4. The institutes based their revised 2007/2008 forecasts on the following assumptions:

- U.S. economic growth of 2.0-2.5% in 2007 and 2.3-3.0% in 2008;
- Euro area growth of 2.5-2.7% in 2007 and 2.2-2.3% in 2008;
- EU-27 growth of 2.8-2.9% in 2007 and 2.4-2.5% in 2008;
- German growth of 2.3-2.5% in 2007 and 2.0-2.3% in 2008;
- oil prices of \$61-64 per barrel in 2007 and \$62-64 in 2008; and
- dollar/Euro exchange rates of 0.75-0.77 in 2007 and 0.71-0.77 in 2008.

¶5. Parallel to the improved economic outlook, the risks associated with the forecasts have also risen, particularly the expected weakening of the U.S. economy. The forecasts assume a soft landing and only a temporary weakening. A stronger than expected downturn in the U.S. economy, likely accompanied by a further strengthening of the Euro, would dampen Austria's growth prospects.

Unemployment Down, But No Further Improvements

¶6. Robust economic growth will have a noticeable impact on the labor market in 2007. After the creation of 50,000-60,000 jobs in 2006, a 3.0% growth rate in 2007 should spur continued strong employment growth. However, since Austria's labor supply will also show strong growth, the number of unemployed will drop by only 19,000-23,000 in 2007. The unemployment rate will ease to 4.2-4.5% from 4.8% in 2006. Due to expected lower growth in 2008, economists do not expect further labor market improvements. The unemployment rate will remain at 4.1-4.4% in 2008. Mid-term forecasts indicate that the unemployment rate will remain at that level until 2011.

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Inflation No Problem

¶7. Inflation will remain at 1.6-1.8% in 2007/08. Moderate wage increases have helped keep inflation low. Slow growth in private consumption will also exert a dampening effect on prices.

Deficit Down, But Should Be Better

¶8. Strong growth has produced higher than expected tax revenues, particularly higher corporate tax and VAT revenues. The 2006 total public sector deficit has been revised downward to 1.1% instead of the budgeted 1.7%. For 2007, the GoA has budgeted for a total public sector deficit of 0.9% of GDP (federal government -1.3%, state and local governments +0.4%), and a 2008 deficit of 0.7% (federal government -1.2%, state and local governments +0.5%). WIFO and IHS noted that a deficit of 1.0% or more is too high, given that Austria is at the peak of a robust growth cycle. Both institutes called for further structural reforms and to resist spending the additional tax windfalls (ref B).

¶9. Statistical Annex

Austrian Economic Indicators (percent change from previous year, unless otherwise stated)

	WIFO project. 2007	IHS project. 2007	WIFO project. 2008	IHS project. 2008
Real terms:				
GDP	3.0	2.9	2.4	2.6
Manufacturing	6.0	n/a	3.3	n/a
Private consumption	2.2	2.4	2.0	2.1
Public consumption	1.7	1.0	1.6	1.0
Investment	5.5	4.8	3.4	3.8

Exports of goods	8.3	9.1	7.0	8.3
Imports of goods	8.5	8.5	6.5	7.5
Nominal Euro billion equivalents:				
GDP	268.7	268.6	280.0	279.9
Other indices:				
GDP deflator	1.8	1.8	1.7	1.5
Consumer prices	1.7	1.6	1.8	1.6
Unemployment rate	4.2	4.5	4.1	4.4
Current account (in percent of GDP)	2.2	n/a	2.3	n/a
Exchange rate for US\$ 1.00 in Euro	0.75	0.77	0.71	0.77

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